The ebb and flow of interest in electricity deregulation and “choice” tracks almost exactly with the market price of natural gas and the presence or absence of excess generating capacity. In the mid-1990’s when the push for “choice” began, natural gas prices were very low and stable. After the California deregulation crisis in 2000 and 2001, market prices soared and a number of states abandoned restructuring. In the middle of the last decade, with natural gas prices soaring, “independent” power prices soared and interest in “choice” dried up, nationally as well as in Michigan. (See New York Times article printed below.) In the last couple years, natural gas prices plummeted, and the recession resulted in some excess capacity and some “cheap” power available, resulting in a new surge of interest in “choice”. This is not a way to build a stable, reliable, and sustainable electric system.

Most importantly, whenever large customers jump off the regulated system to pursue “choice”, all other customers left behind must pick up the costs that those customers avoid. Any Michigan policy examination of “choice” must weigh the benefits to customers that jump to “choice” vs. the costs to all other customers. There is no such thing as a “free lunch” from expanding “choice”. There are winners and losers. (And worse yet, history has shown the “winners” seek to jump back on the regulated system when the “market” prices soar.)

Today's NYT on the failure of electricity restructuring, 1st of a four part series:

Competitive Era Fails to Shrink Electric Bills

By DAVID CAY JOHNSTON
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A decade after competition was introduced in their industries, long-distance phone rates had fallen by half, air fares by more than a fourth and trucking rates by a fourth. But a decade after the federal government opened the business of generating electricity to competition, the market has produced no such decline.

Regulated Monopolies or Competitive Markets? Instead, more rate increase requests are pending now than ever before, said Jim Owen, a spokesman for the Edison Electric Institute, the association for the investor-owned utilities that provide about 60 percent of the nation’s power. The investor-owned electric utility industry published a June report entitled “Why Are Electricity Prices Increasing?”

About 40 percent of all electricity customers — those in 23 states and the District of Columbia where new competition was approved — mostly paid modestly lower prices over the past decade. But those savings were primarily because states, which continue to have some rate-setting power, imposed cuts, freezes and caps at the behest of consumer groups that wanted to insulate customers from any initial price swings.

The last of those rate protections expire next year, and the Federal Energy Regulatory Commission and other federal agencies warn in a draft report to Congress that “customers may experience rate shock” as utilities seek to make up for revenue they did not collect during the period of artificially reduced prices and to cover higher costs of fuel. They warned that “this rate shock can create public pressure” to turn back from electricity prices set by the market to prices set by government regulators.

The disappointing results stem in good part from the fact that a genuinely competitive market for electricity production has not developed.

Concerned about rising prices, California and five other states have suspended or delayed transition to the competitive system.

And voters around two California cities, Sacramento and Davis, will decide next month whether to replace investor-owned utilities with municipal power in hopes of lowering rates. Drives are under way to expand public power in Massachusetts. In Portland, Ore., the city council tried and failed to buy the local utility company.

Electric customers in other states are facing rude surprises.

In Baltimore, an expected 72 percent rate increase in electricity prices has aroused so much protest that the state legislature met in special session, where it arranged to phase in the higher costs over several years. In Illinois, rates are about to rise as much as 55 percent.

The three New York area states opened their electricity markets to competition, with different results.

In Connecticut, residential electric rates rose up to 27 percent last year to an average of $128 a month, and are expected to go up as much as 50 percent more in January.

In New Jersey, rates rose up to 13 percent this year, and are poised to go much higher.

New York residential customers, by contrast, paid an inflation-adjusted average of 16 percent less in 2004 than in 1996, a state report said. It is not known how much of that is attributable to government-ordered rate cuts, but the state benefited from huge increases in power generated by its nuclear plants and by buying power from New England plants that, starting next year, may have less electricity to sell to New York.

The Federal Energy Regulatory Commission and five other agencies, in the draft of the report to Congress, are unable to specify any overall savings. “It has been difficult,” the report states, “to determine whether retail prices” in the states that opened to competition “are higher or lower than they otherwise would have been” under the old system.

Joseph T. Kelliher, the commission chairman, said Friday that eventually

“market discipline will deliver the best prices” and noted that every administration and Congress since 1978 had pushed the industry toward competition. He added that the commission recognized a need for “constant reform of the rules.”

Under the old system, regulated utilities generated electricity and distributed it to customers. Under the new system, many regulated utilities only deliver power, which they buy from competing producers whose prices are not regulated. For example, Consolidated Edison, which serves the New York City area, once produced almost all the power it delivered; now it must buy virtually all its electricity from companies that bought its power plants and from other independent generators.

The goal is for producers to compete to offer electricity at the lowest price, savings customers money. Independent power producers, free-market economists and the Clinton Administration cheered in 1996 when the federal government allowed states to adopt the new system. The new rules “will benefit the industry and consumers to the tune of billions of dollars every year,” Elizabeth A. Moler, then chairwoman of FERC, said at the time. She said the new rules would “accelerate competition and bring lower prices and more choices to energy customers.”

Regulated Monopolies or Competitive Markets? But that has not happened. A truly competitive market has never developed, and, in most areas, the number of power producers is small. In New Jersey, for example, only six companies produce power, and not all of them sell to every utility.

Some utilities have decided to buy electricity not from the cheapest supplier but from one owned by a sister to the utility company, even if that electricity is more expensive. That has been the case in Ohio.

And if electricity is needed from more than one producer, utilities pay each one the highest price accepted in the bidding, not the lowest. This one-price system, adopted by the industry and approved by the federal government, is intended to encourage investment in new power plants, which are costlier than older ones.

But critics say that, as in California five years ago in a scandal that enveloped Enron, the auction system can be manipulated to drive up prices, with the increases passed on to customers. What is more, companies that produce electricity can withhold it or limit production even when demand is at its highest, lifting prices. This happened in California, and the federal commission has found that it occurred in a few more instances since then. Critics say that more subtle techniques to reduce the supply of power are common and that the commission shows little interest in investigating.

Bryan Lee, a FERC spokesman, said complaints of manipulation are investigated, but only last year did Congress give the commission the legal tools to punish manipulators.

Under the new system there have been some big winners — including Goldman

Sachs and the Carlyle Group, the private equity firm — that figured out that there were huge profits to be made in one area of the new system.

Such investors have in some cases resold power plants they just bought, making a large profit. In other cases, investors have bought power plants from the utilities at what proved to be bargain prices, then sold the electricity back at much higher prices than it would have cost the utility to generate the electricity.

Richard Blumenthal, the Connecticut attorney general, said the supposedly competitive market has been “a complete failure and colossal waste of time and money.”

He asked the federal commission to revoke competitive pricing in his state, but the commission dismissed the complaint last Wednesday, saying the state had not proved its case.

Advocates of moving to the new system say that, in time, the discipline of the competitive market will mean the best possible prices for customers. Alfred E. Kahn, the Cornell University economist who led the fight to deregulate airlines and who, as New York’s chief utility regulator in the 1970’s, nudged electric utilities toward the new system, said that he was not troubled by the uneven results so far.

“Change,” Professor Kahn said, “is always messy.”

But some advocates of introducing competition to the electric industry have soured on the idea. They include the Cato Institute, a leading promoter of libertarian thought that favors the least possible regulation and that concluded earlier this year that government and electric utilities have made such hash of the new system that the whole effort should be scrapped.

“We recommend total abandonment of restructuring,” Cato said. If the public rejects a greater embrace of markets, Cato wrote, the next best choice would be a “return to an updated version of the old” system.

The conflicting results among the many studies of electric prices stand in contrast to the sharp, unambiguous drops in the prices of telephone calls, air travel and trucking.

One study by the utility economist Mark L. Fagan, a senior fellow at the Kennedy School of Government at Harvard and a consultant to various businesses who favors a competitive system, found that the new system often produces better results. He found that in 12 of 18 states that restructured, prices were lower for industrial customers than they would have been under the old system. But he also found that prices were somewhat lower than his model predicted in seven of 27 states that did not open to competition.

In Virginia, a state that did not move to the new system, a report last month by the agency that regulates utilities found “no discernible benefit” to customers in the 16 states that had gone the farthest and warned that

electricity prices in those states “may actually be increasing faster than for customers in states that did not restructure.”

And Professor Jay Apt, a former astronaut who runs the electricity study center at Carnegie-Mellon University, found that savings from introducing competition to sales of electricity to large industrial customers “are so small that they are not meaningful.”

Regardless of the debate over the effectiveness of the new system, electricity prices are expected to rise in the next few years for several reasons apart from any rise in the price of coal, natural gas, oil, uranium and other fuels.

A study issued in June by the Edison Foundation, which represents investor-owned utilities concluded that utilities would have to raise rates to upgrade local distribution systems and to finance long-distance transmission lines, as well as for new power plants. The study found that utility profit margins had thinned and financial strength had weakened. It called for relief in the form of higher rates.